87-05705/

MANFOR LTD.
BOARD OF DIRECTORS

Murray Harvey – Chairman
Ken Cassan – The Pas
Ron Gareau – The Pas
Wayne Halverson – The Pas
Eugene Krochak – Cranberry Portage
John Milner – Cranberry Portage
Lloyd Schreyer – Winnipeg
Grant Wilson – Winnipeg
Robert Wilson – Winnipeg

■ Management

S.E. Balmer – President
D.W. Betts – Comptroller
A.D. Bourgeois – Manager, Marketing
F. Ellis – Manager, Human Resources
W.J. Henderson – Manager, Planning and Development
W.E. Jonas – Manager, Lumber and Woodlands
W.J. Veitch – Manager, Engineering and Maintenance
G.M. Wazny – Manager, Pulp and Paper

Manitoba

Winnipeg, Manitoba, CANADA
R3C 0V8

April 29, 1987

The Honourable George Johnson
Lieutenant-Governor
Province of Manitoba
Winnipeg, Manitoba
R3C 0V8

May It Please Your Honour:

I have the honour to submit the Annual Report of Manfor Ltd. for the period ended December 31, 1986.

Respectfully submitted,

Jerry Storie
Minister

MANFOR LTD.
OFFICE OF THE CHAIRMAN OF THE BOARD
148 Fischer Avenue, Box 2872, The Pas, Manitoba R9A 1M6
Phone (204) 623-3788 Telex 07-666578

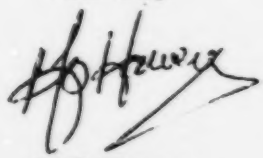
April 23, 1987

Honourable Jerry Storie
Minister Responsible for Manfor Ltd.

Sir:

In accordance with Section 8 (1) of The Manitoba Natural Resources Development Act, I have the honour to present the Annual Report for Manfor Ltd., for the year ended December 31, 1986.

Yours truly,



M.O. Harvey
Chairman of the Board
Manfor Ltd.

CHAIRMAN'S MESSAGE

Investments made in mill modernization and changes made in company operations began to pay off in 1986, contributing to a year of substantial progress at Manfor.

Last year, the company demonstrated its best financial performance since 1981. Record sales revenues of $79 million were reached and the company realized a net profit of $2.6 million before depreciation.

Even more important were the developments with long-term implications for Manfor's future. Throughout the year, the company recorded a steady trend of improved performance, not only in terms of financial results but also in terms of the quality and quantity of goods produced. Steady improvement along these lines is essential to Manfor's well-being.

There are several reasons for this trend of improved performance.

In the pulp and paper operations, Manfor strengthened its position in the U.S. by demonstrating its ability to provide reliable, on-time delivery of a high-quality product. This resulted in the company's accelerated production of Super Performance Kraft (SPK) paper and increased deliveries to the U.S. market. These turned out to be major factors given the emergence in midyear of Manfor as the sole North American supplier of this high-quality, multi-wall kraft paper.

At the same time, the company withdrew from regular pulp production as part of an overhaul of its product line. The grade-mix improvements which arose from these developments made an important contribution to the company's improved financial picture as did price increases in the fall.

Manfor's sawmill operation also experienced a trend toward increased production, in spite of adverse external conditions. A four-week shutdown was necessary due to a sawlog shortage created by abnormal weather conditions. An element of uncertainty was added to the sawmill's economic position by the prolonged U.S. softwood lumber countervail duty dispute.

Late in the year, the International Woodworkers of America and the company negotiated a series of deferrals to the collective agreement for 1987 to improve the economics of the company's operations.

In 1986, the company continued to streamline its organizational structure. Integrated business planning, more effective organization, and management restructuring received special attention.

Significant changes were made in the structure and composition of senior management. The goals were to improve effectiveness and to develop a work environment which emphasized co-operation and participation. One such change was the consolidation of all maintenance and engineering under the authority of a member of the senior management team in order to improve the effectiveness of maintenance management and the utilization of company resources.

A reorganization of the human resources department put increased emphasis on the development of company-wide loss prevention programs and on the improvement of the company's overall organizational effectiveness.

As part of the long-term plan for supplying wood fibre, the program for restructuring woodlands operations initiated late in 1985 was continued in 1986.

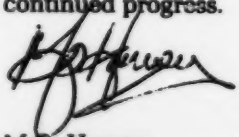
Consistent with the company's strategy of consolidating its business activities, a program to sell residential real estate holdings was initiated.

The outlook for 1987 is promising, due largely to record paper prices and Manfor's unique position in strengthened paper markets.

Nevertheless, the key to improving the viability of Manfor's operations is reducing the company's vulnerability to swings in market cycles through continued productivity growth and cost control. Lumber markets are particularly uncertain. Manfor, like the entire Canadian forest industry, is sensitive to international trade difficulties, including adverse changes in foreign exchange rates.

During the first quarter of 1987, production records have been achieved in both the paper mill and sawmill. The unaudited financial results for the first quarter indicate a net profit of $1.6 million. If current trends are sustained throughout the year, 1987 will be one of the best years in Manfor's history.

The achievements of 1986 are a credit to all at Manfor, especially those employees who, in the interest of the company, postponed receipt of certain benefits due them including salaries and wages. These achievements represent a step forward in the ultimate task of securing Manfor's economic future. The commitment each employee makes to productivity, quality, and cost-consciousness has important influences on the company's continued progress.



M.O. Harvey
Chairman of the Board
Manfor Ltd.

Manfor Operations

■ Manfor's business strategy

In the past few years, Manfor has developed a multifaceted business strategy founded on solid, basic business activities that will result in improved productivity.

At the core of Manfor's business strategy is a $50 million modernization program completed in 1985. In the paper mill, this capital program has enabled us to target an opening in the U.S. high-quality multi-wall paper market by delivering a superior product. In the sawmill, the capital program has allowed us to become more competitive by improving productivity and reducing costs.

As the bottom line shows, Manfor's business strategy is proving itself.

■ Marketing

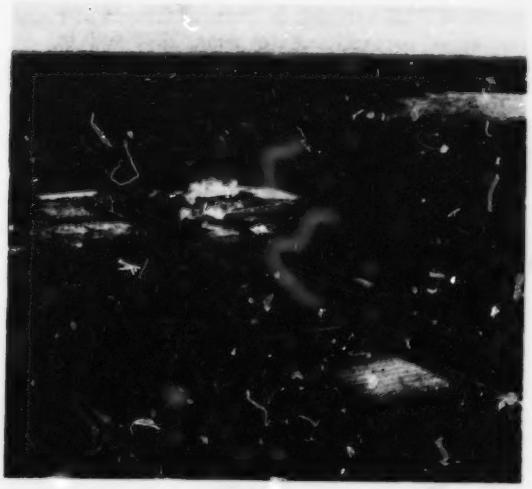
The outlook for Manfor's special multi-wall paper production is favourable because the product is unique. The demise in 1986 of the only other North American source of high-performance, multi-wall, unbleached kraft paper has provided Manfor with an unequalled opportunity to demonstrate its ability to supply quality product on time.

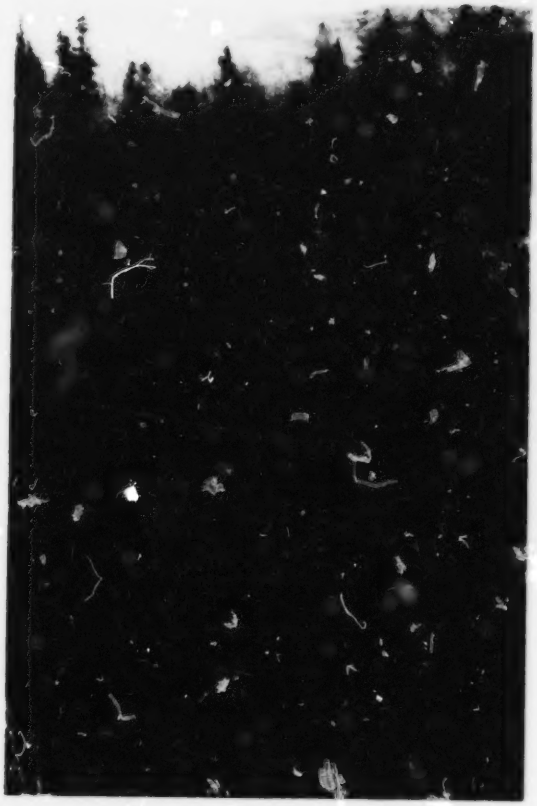
Late in 1986, Manfor's marketing plan was reviewed, resulting in a decision to focus on the giant North American paper market. Now, as marketing efforts concentrate more and more on the U.S., the development of SPK markets will continue to outpace projections made at the time of company modernization. The level of sales is already three years ahead of these predicted figures. Multi-wall shipping sacks for agricultural and construction industries continue to be important end-user markets for our paper. The company is also developing new uses for its unique paper product.

As a result of these developments, Manfor has emerged as a strong force in the North American multi-wall market.

In 1987, the phased elimination of the 15 percent Canadian protective tariff on unbleached kraft paper was completed. In effect, Manfor now operates in a free trade environment for its paper sales. This situation has triggered the creation of a company business strategy that has transformed Manfor from a domestic market-oriented firm into an internationally competitive exporter.

The outlook in lumber markets is uncertain. A major unknown is the ultimate impact the 15 percent export charge imposed on Canadian softwood lumber destined for the U.S. will have on future prices and the volume of export sales. In the coming year, efforts will be intensified to define the role of the sawmill in the company's future strategy.





Production

Pulp and paper

In 1986 Manfor's pulp and paper operation achieved an annual production record exceeding 125,000 tonnes of quality pulp and paper. Control programs were intensified to ensure optimal quality and special attention to customer's technical requirements. Maintenance priorities identified the need for preventative programs and the development of more effective employee participation programs.

Lumber

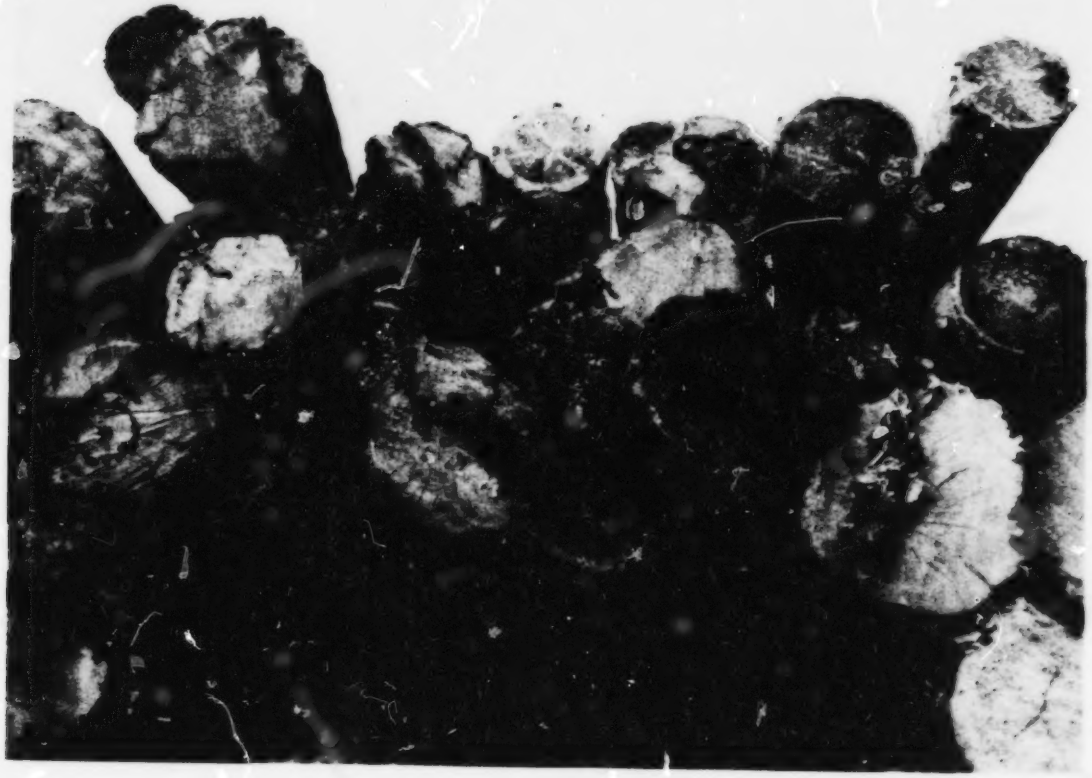
Sawmill production increased throughout the year, totalling 43 million board feet. The newly installed, modern sawmill equipment required extensive efforts to make the sophisticated computer technology function properly. Maintenance priorities centred on substantial modifications to the production machinery to achieve the required uptime. Production was curtailed by a four-week shutdown in September due to a shortage of saw logs created by abnormally wet weather conditions in woodland areas.

Woodlands

During 1986, Manfor's woodlands operations produced more than 500,000 cubic metres of wood. The normal summer vacation shutdown of the cut and skid operations was extended to bring fibre inventories in line.

Cutting operations were fully established in the Thompson area and changes were made in trucking arrangements to improve the cost-effectiveness of log delivery to the mill site. Twenty-six kilometres of logging roads were constructed.

In 1986, Manfor spent $1.1 million on reforestation activities, with approximately $400,000 of this provided through the Canada/Manitoba Forestry Agreement. As Manfor advances towards its goal of reforesting 100 percent of annually harvested areas by 1990, more than 2.8 million trees were planted and 2700 hectares prepared for renewal in 1986. The second year of a herbicide trial program was completed in compliance with provincial environmental regulations and in consultation with a local advisory committee.



MANFOR LTD. FINANCIAL REPORT

Manitoba

MANFOR LTD.
REPORT OF THE PROVINCIAL AUDITOR'S OFFICE

We have examined the balance sheet of Manfor Ltd. as at December 31, 1986 and the statements of operating deficit, operations and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these financial statements present fairly the financial position of the Company as at December 31, 1986 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Our opinion with respect to the comparative amounts shown for the 15 month period ended December 31, 1985 was qualified because the write-off of deferred charges is disclosed in the Statement of Operating Deficit whereas generally accepted accounting principles require such write-offs to be reflected in the Statement of Operations before the transfer of the net loss for the period to the Statement of Operating Deficit.

F.H. Jackson, C.A.,
Provincial Auditor.

April 16, 1987,
Winnipeg, Manitoba.

STATEMENT OF OPERATIONS

FOR THE YEAR ENDED DECEMBER 31, 1986
(with comparative figures for the period ended December 31, 1985)

	1986	1985
	(Thousands of Dollars)	
NET SALES		
Paper	$69,497	$59,507
Lumber	8,945	3,901
Other	612	850
	79,054	64,258
EXPENSES		
Cost of sales	66,512	73,670
General & administrative	9,956	12,673
	76,468	86,343
OPERATING PROFIT (LOSS)	2,586	(22,085)
OTHER EXPENSES (INCOME)		
Interest	(133)	785
Depreciation – note 1	7,871	8,531
Loss (Gain) on sales of fixed assets	126	(54)
	7,864	9,262
NET LOSS FOR THE PERIOD	$ 5,278	$31,347

STATEMENT OF OPERATING DEFICIT

FOR THE YEAR ENDED DECEMBER 31, 1986
(with comparative figures for the period ended December 31, 1985)

	1986	1985
	(Thousands of Dollars)	
BALANCE, BEGINNING OF PERIOD	$126,227	$ 89,782
Write-off of start-up and development costs	—	5,098
Manitoba Development Corporation recoveries – note 7	(3,002)	—
Net Loss for the Period	5,278	31,347
BALANCE, END OF PERIOD	$128,503	$126,227

BALANCE SHEET

AS AT DECEMBER 31, 1986
(with comparative figures at December 31, 1985)

Assets

	1986	1985
	(Thousands of Dollars)	
CURRENT		
Cash and short-term deposits	$ 8,211	$ 699
Accounts receivable – note 2	11,477	9,888
Inventories – notes 1 and 3	22,066	24,328
Prepaid expenses	877	1,211
	42,631	36,126
LONG-TERM RECEIVABLES	—	1,006
FIXED – notes 1 and 4		
Land, buildings, machinery, roads, logging facilities, and equipment	151,172	150,197
Rental housing properties	1,497	2,030
	152,669	152,227
Less accumulated depreciation	59,832	52,817
	92,837	99,410
	$135,468	$136,542

Liabilities

	1986	1985
	(Thousands of Dollars)	
CURRENT		
Bank indebtedness	$ —	$ 948
Accounts payable and accrued liabilities	7,445	8,330
Current portion of mortgages payable	21	53
	7,466	9,331
MORTGAGES PAYABLE – note 5	865	1,096
	8,331	10,427

Share capital and deficit

SHARE CAPITAL – note 6	255,640	252,342
OPERATING DEFICIT	(128,503)	(126,227)
	127,137	126,115
	$135,468	$136,542

Approved on behalf of the Board:

M.O. Harvey Director

Robert R Wilson

R.R. Wilson Director

STATEMENT OF CHANGES IN FINANCIAL POSITION

FOR THE YEAR ENDED DECEMBER 31, 1986
(with comparative figures for the period ended December 31, 1985)

	1986	1985
	(Thousands of Dollars)	
CASH PROVIDED BY (USED FOR)		
Operating Activities		
Net loss	$(5,278)	$(31,347)
Items not involving cash:		
Depreciation, amortization, and depletion	7,871	8,531
	2,593	(22,816)
Net change in non-cash working capital balances related to operations	1,127	(5,912)
	3,720	(28,728)
Financing Activities		
Issue of preferred shares	6,300	68,322
Government grant relating to capital expenditure	—	4,871
Decrease in long-term debt	(263)	(73)
Decrease in long-term receivables	—	53
	6,037	73,173
Investing Activities		
Additions to fixed assets	(2,855)	(42,361)
Net proceeds from disposal of fixed assets	1,558	252
	(1,297)	(42,109)
INCREASE IN CASH	8,460	2,336
CASH AT BEGINNING OF PERIOD	(249)	(2,585)
CASH AT END OF PERIOD	$8,211	$ (249)

Cash position represents cash less bank loans.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 1986

(with comparative figures for the period ended December 31, 1985)

1. SIGNIFICANT ACCOUNTING POLICIES

The following is a summary of significant accounting policies of the company.

a. **Inventories**

Inventories are valued using the following methods:

Logs, work in process, and finished goods – lower of cost and net realizable value

Mill stores and other supplies – lower of cost and replacement cost

Cost is generally determined on an average cost basis.

b. **Depreciation**

Depreciation is being applied on the following basis:

Fixed assets, except those pertaining to the Woodlands and Real Estate Divisions and all mobile equipment, are depreciated on a straight-line pooled basis over twenty years. The cost of fixed assets removed, less recovery from disposal proceeds, is charged to accumulated depreciation. During the year, $1,111,000 of fixed assets were so removed. Capitalized start-up development costs relative to the modernization are amortized over ten years. Gains and losses incurred on the disposal of fixed assets pertaining to the Woodlands and Real Estate Divisions and mobile equipment are credited or charged to operations.

Woodlands Division

Camp buildings – Straight-line over ten years

Logging equipment – Hours used related to estimated total useable hours

Roads & railspurs – Timber delivered to the millsite related to estimated total yield of area serviced

Other equipment – Straight-line over three to twenty years

Real Estate Division

Rental housing properties – Straight-line over forty years

Mobile equipment – Hours used related to estimated total useable hours

c. **Foreign Exchange**

Current assets and liabilities of the company expressed in United States dollars are translated into Canadian dollars at the rate of exchange on the balance sheet date. The resulting net gain or loss is reflected in operations.

2. ACCOUNTS RECEIVABLE

	1986	1985
	(Thousands of Dollars)	
Trade	$10,134	$8,883
Due from Receiver	—	117
Other	337	888
D.R.I.E. Grant Receivable	1,006	—
	$11,477	$9,888

3. INVENTORIES

Inventories consist of the following:

	1986	1985
	(Thousands of Dollars)	
Logs	$10,480	$10,120
Work in process	2,309	3,275
Finished goods	1,150	2,746
Mill stores and other supplies	8,127	8,187
	$22,066	$24,328

4. FIXED ASSETS

Land, buildings, machinery, roads, logging facilities and equipment, except the machinery plant, were valued on the basis of inventoried expenditures to the date of receivership, January 7, 1971, amounting to $64,753,000 including a reasonable assessment for engineering and supervision fees and interest charges. The Engineering Division fixed assets were valued at $500,000 on the basis of an estimated useful value to the integrated operations at January 7, 1971. Subsequent fixed asset additions and construction in progress as at December 31, 1986, have been recorded at cost. The company has deducted government grants received or receivable from the cost of fixed assets acquired. These grants aggregated $22,500,000 as at December 31, 1986.

5. MORTGAGES PAYABLE

	1986	1985
	(Thousands of Dollars)	
On rental properties with interest rates from 6.75% to 9.75% maturing 1995 to 2006	$886	$1,149
Less current portion	21	53
	$865	$1,096

Subsequent to the year end, the rental housing properties securing these mortgages have been or are likely to be sold in 1987 resulting in the elimination of these mortgages.

6. SHARE CAPITAL

The company is wholly-owned by the Province of Manitoba and is incorporated under the authority of The Manitoba Natural Resources Development Act.

Shares Authorized:

Common Shares:
Unlimited number of shares of $1 par value.

Preferred Shares:
Class "A"
Unlimited, non-participating, non-voting, carrying a non-cumulative dividend entitlement of 7%, redeemable at $1 per share.

Class "B"
Unlimited, retractable, non-voting, carrying a cumulative dividend entitlement of 11%, redeemable at $1 per share.

Shares Issued:

Common shares at December 31, 1985 and 1986	$ 20,000,000
Class "A" preferred shares at December 31, 1985	$193,823,028
Add: Issued during the year to the Province of Manitoba for additional funding	6,300,000
Less: Redeemed during the year by the Province of Manitoba – note 7	3,002,219
Class "A" preferred shares at December 31, 1986	$197,120,809
Class "B" preferred shares at December 31, 1985 and 1986	38,519,000
Total shares issued at December 31, 1986	$255,639,809

The arrears of dividends on the Class "B" preferred shares at December 31, 1986, was $8,926,204. (December 31, 1985, $4,689,114)

7. SHARE REDEMPTION

According to an agreement between the Province of Manitoba, the Manitoba Development Corporation and Manfor Ltd., the Manitoba Development Corporation is required to carry out the remaining actions with regard to the receivership and to pay the necessary charges and make appropriate recoveries. The Province of Manitoba is to receive from the Manitoba Development Corporation any recoveries realized. Manfor Ltd. is to reflect the recoveries by the Province of Manitoba through a cancellation of its preferred shares and an adjustment of capital deficit.

During the year, the Manitoba Development Corporation received $3,002,219 from the settlement of a lawsuit which was paid to the Province of Manitoba. As of April 1, 1983, the accumulated capital deficit of Manfor Ltd. of $59 million was written off by Order-In-Council No. 1296 dated November 30, 1985. The redemption of shares has been recorded as an adjustment to the operating deficit.

8. UNFUNDED ACTUARIAL LIABILITY

The pension plan for hourly paid employees represented by the Canadian Paperworkers Union was amended effective December 1, 1980, and December 1, 1983, to increase monthly pension benefits. On the basis of an actuarial valuation, this benefit improvement created an unfunded liability. At December 31, 1986, the balance unfunded is $244,943 which will be funded by annual installments of $26,132 for each of the years 1987 to 2000 in accordance with The Pension Benefits Act. The next valuation of the plan has been undertaken as of December 31, 1986.

9. ECONOMIC DEPENDENCE

The company is economically dependent on the Government of the Province of Manitoba.

10. COMPARATIVE FIGURES

The year end of the company was changed to December 31 at December 31, 1985. As a consequence, the figures shown for 1985 are for a fifteen-month period as compared with the twelve-month period to December 31, 1986. Certain figures for the preceding period have been reclassified to conform with the presentation adopted in 1986.